TO: THE CHIEF EXECUTIVE OR MANAGING OFFICER OF ALL LOUISIANA STATE-CHARTERED BANKS AND THRIFTS

FROM: SID SEYMOUR, CHIEF EXAMINER

DATE: NOVEMBER 9, 2007

RE: LOUISIANA OFFICE OF FINANCIAL INSTITUTIONS (OFI) UPDATE

Outreach Initiative – Over the last 12 months, Commissioner Ducrest and I have made an effort to attend as many Exit Board Meetings as possible in order to discuss regulatory trends and stress the importance of community institutions to the economic well being of the state. We've also been asking what are the greatest challenges to remaining independent, community institutions. The comments we most often hear include the following: heavy regulatory burden; difficulties in hiring and retaining competent staff; difficulties in attracting new, and younger directors; and financial fraud of various types. While we support reduced regulatory burden, we encourage you to look upon this Office as not only a regulatory agency but also a resource to your institution. We plan to continue to attend as many Exit Board Meetings as possible in order to meet with you and your directors, and have also encouraged our District Office Managers to continue their informal contacts, outside of the examination process, at least annually. While everyone seems to agree that the financial services industry has become increasingly more complicated and competitive, key performance indicators remain strong and reflect favorably on management of the financial institutions domiciled in the State of Louisiana. We recognize your continued efforts in this regard.

New Initiatives –This Office continues to strive to be a valuable resource to your institution by being proactive, knowledgeable, and responsive to your needs. Beginning in 2008, the following new initiatives will be implemented in order to reduce the regulatory burden on state-chartered financial institutions:

(1) Examination frequency- This Office will be moving out its examination frequency for 1- and 2- rated banks and thrifts that are well-capitalized, well-managed, and have total assets of less than $500 million to approximately 18 months. Since the re-shuffling of our schedules may present conflicts, it may not be possible to move all of these examinations out to 18 months immediately, but we will do our best to keep the examinations of the strongest institutions out to the furthest extent.

(2) More examination report review in field- This Office has successfully completed the first phase of having its examination reports of our banks and thrifts that are rated 1 with less than $500 million in total assets completed in our district offices and mailed directly to you. Now, we will add the 2-rated banks to this list. We are hopeful that this initiative will reduce the time between the examiners' completion of an examination and the time that it takes for you to get the examination report. We realize that the quicker we can get the information back to you, the sooner you can start working on correcting any deficiencies.

(3) Non-complex holding company inspections- A review of your parent company will be done in conjunction with our bank/thrift examination. By doing these examinations as part of the safety and soundness examinations, it should take less time for each inspection and eliminate the additional charge that is currently assessed for the separate holding company inspection.

Overall Financial Condition - As of June 30, 2007, there were 166 banks and thrifts domiciled in the State of Louisiana, with 133 or approximately 80% being state-chartered. Our June 30, 2007, Economic Update may be accessed on our website, www.ofi.louisiana.gov, by either clicking the bank or thrift links, and then OFI Financial Reports – June 30, 2007.

Banks - The overall financial condition of Louisiana-domiciled banks remains sound at the present time. The second quarter of 2007 was characterized by increases in total assets and total deposits, and a slight decline in Tier 1 (core) capital. During the second quarter, core deposits as a percent of total deposits and borrowed money decreased to its lowest level in the past 18 quarters. Earnings increased from the previous quarter and remained satisfactory. With Tier 1 (core) capital shrinking slightly and quarterly average assets growing, the Core capital (leverage) ratio decreased; however, capital ratios remain well above minimum regulatory requirements. During the second quarter of 2007, the dollar volume of nonperforming assets and the ratio to total assets both decreased; however, net charge-offs increased. Based on the CAMELS rating scale used by state and federal regulators, the financial condition of the Louisiana banking industry remains sound. The following chart reflects the composite ratings of all banks domiciled in the State of Louisiana as of June 30, 2007.

CAMELS Ratings for All banks domiciled In Louisiana @ 6/30/07

Composite CAMELS	All Banks	%	State Banks	%	National Banks	%
Rating of "1"	89	64%	82	66%	7	50%
Rating of "2"	46	33%	39	31%	7	50%
Rating of "3"	3	2%	3	2%	0	0%
Rating of "4"	1	1%	1	1%	0	0%
Rating of "5"	0	0%	0	0%	0	0%
Not yet rated	0	0%	0	0%	0	0%
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TOTAL	139		125		14	

Thrifts - The overall financial condition of Louisiana-domiciled thrifts remains sound at the present time. The second quarter of 2007 was characterized by a modest increase in Tier 1 (core) capital, and increases in total assets and deposits. The quarter also saw an increase in borrowed money, primarily FHLB advances, as well as an increase in core deposits. Earnings are fair, continuing to decline primarily because of increased non-interest expenses, and the net interest margin continues to decline because of lower yields and increased cost of funds. Lower net income and growth in average assets has compacted the return on assets. With the modest increase in Tier 1 (core) capital and an increase in quarterly average assets, the Core capital (leverage) ratio declined during the second quarter; however, capital ratios remain well above regulatory minimums. During the second quarter, nonperforming assets increased, and the industry reported net charge-offs rather than the net recoveries reported in the prior quarter. Based on the CAMELS rating scale used by state and federal regulators, the financial condition of the Louisiana thrift industry remains sound. The following chart reflects the composite ratings of all thrifts domiciled in the State of Louisiana as of June 30, 2007.

CAMELS Ratings For All Thrifts domiciled In Louisiana @ 6/30/07

Composite CAMEL	All Thrifts	%	State Thrifts	%	Federal Thrifts	%
Rating of "1"	21	78%	7	88%	14	74%
Rating of "2"	5	18%	1	12%	4	21%
Rating of "3"	1	4%	0	0%	1	5%
Rating of "4"	0	0%	0	0%	0	0%
Rating of "5"	0	0%	0	0%	0	0%
Not yet rated	0	0%	0	0%	0	0%
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TOTAL	27		8		19	

2007 Legislative Fiscal Session – All three of the OFI bills that were introduced during the recent Legislative Fiscal Session were passed and signed by the Governor. One bill in particular, HB 314 (Act 36) established an online licensing system for our licensees under the Residential Mortgage Lending Program that will greatly assist state agencies nationwide in detecting and preventing mortgage loan fraud. If you want more information about this online database, please contact Deputy Chief Examiner Darin Domingue at 225/922-2596 or by email at ddomingue@ofi.louisiana.gov. The enrolled bills are available on the Legislature's website at: www.legis.state.la.us. Please contact General Counsel Sue Rouprich at 225/922-1028 or by email at srouprich@ofi.louisiana.gov with any questions. We are currently considering legislation for the upcoming 2008 Legislative Regular Session and will be meeting with the LBA in the very near future to discuss our legislative package.

Concentrations in Commercial Real Estate (CRE) Lending – As mentioned previously, state and federal banking agencies (FBAs) are focusing on institutions that have substantial risks associated with CRE lending concentrations and stressing the need to have enhanced risk management practices and procedures in place to deal with the high degree of risk inherent in such portfolios. Beginning with the March 31, 2008, Call Report, all institutions will be required to provide more information on their CRE lending portfolios. It is very important that your management information system is properly programmed in order to identify owner-occupied versus non-owner-occupied CRE in completing the new schedule. Again, institutions should perform their own assessment of concentration risk in their CRE lending portfolios. Institutions that exceed certain CRE concentration thresholds, as detailed in the guidance, are expected to have more sophisticated risk management practices, procedures, and processes in place in order to properly monitor such risk on an ongoing basis. Examiners will continue to review for such concentrations at future examinations and through the off-site monitoring process. If you have not already done so, please be sure to become familiar with the guidance that can be located at http://www.fdic.gov/news/news/financial/2006/fil06104.html. Please contact me directly with any questions.

Fair Lending Reviews – Since the federal banking agencies (FBAs) began using home loan price data obtained under the Home Mortgage Disclosure Act (HMDA) using 2004 data, 3 of our banks have been subject to a closer review. The 2006 home loan price data was recently reviewed and 4 of our banks have been notified that the FDIC will be looking at them closer. Since these reviews can be very time consuming to the management of an institution thus costly to the institution, we thought that we would repeat advice from the previous CEO Update regarding suggestions to improve your program and possibly avoid such reviews:

(1) Be sure that you are reporting correctly—"Garbage In = Garbage Out." Take extra care when reporting the HMDA data, as incorrect reporting may cause outliers that may be costly and time consuming to explain. It may be beneficial for an independent person to double check the initial report before it is finalized and submitted.
(2) Track discrepancies and be aware of them before they persist. There are computer programs that will warn management of loans made outside of the parameters set in the program. With this information, management can identify outliers and ensure that they are properly documented or that the practice is corrected going forward before a long-term pattern is established. As with any MIS data, management must make a point of reviewing the data to ensure that all outliers are appropriate and well documented.
(3) [NEW] More Discretion = More Risk. While deviations from the standard rate sheet are allowed, wider levels of discretion in more judgmental areas could result in more outliers in need of explanation. Management should ensure that the areas in which the loan officers are given discretion are made crystal clear through written policies or checklists with ranges for each area of discretion and a maximum range for all areas of discretion.
(4) Document, document, document. A loan officer may deviate from the standard rate sheet when assigning an interest rate to a mortgage loan for reasons such as the borrower's credit history, loan-to-property value ratio, consumer debt-to-income ratio, competitive factors, or compensating balances; however, acceptable reasons for deviations should be established in written policies and procedures to ensure consistency among loan officers. When a mortgage loan is assigned an interest rate different from the standard rate sheet, the reasons must be properly documented and supported. Unsupported reasons for an exception to the rate sheet will result in further effort and time on behalf of the examining team as well as that of the bank.

Please contact Deputy Chief Examiner Kerry Morris at 225/925-4201 or by email at kmorris@ofi.louisiana.gov with any questions.

Adoption of FAS 157, Fair Value Measurements - FASB Statement No. 157, *Fair Value Measurements* (FAS 157), issued in September 2006, defines fair value, establishes a framework for measuring the fair value of assets and liabilities based on a three-level hierarchy, and expands disclosures about fair value measurements. This statement may be obtained from the following web address: www.fasb.org/pdf/fas157.pdf. FAS 157 is effective for fiscal years beginning after November 15, 2007. For those institutions with calander year-ends, FAS 157 must be adopted as of January 1, 2008, unless calander year-end institutions early-adopted the statement as of Janaury 1, 2007, under the early adoption provisions of the statement. The effect of initially applying FAS 157 to assets and liabilities should be recognized as a cumulative-effect adjustment to the opening balance of retained earnings at the beginning of the fiscal year of adoption. This adjustment should be reported in Schedule RI-A, item 2, "Restatements due to corrections of material accounting errors and changes in accounting principles," and separately disclosed in Schedule RI-E, item 4.

FAS 157 fair value measurements apply to recurring measurements of assets and liabilities recorded at fair value, such as trading and available-for-sale securities and derivatives; items recorded at the lower-of-cost-or-fair value, such as loans held for sale; nonrecurring measurements such as the fair value of foreclosed real estate at acquisition, which establishes its cost basis; impairment tests based on fair value of impaired collateral dependent loans; parcels of foreclosed real estate; servicing assets and liabilities accounted for under the amortization method; and financial statement disclosures of fair value such as those required by FAS 107. FAS 157 changes fair value measurement from the "entrance price" approach traditionally used in accounting to an "exit price" approach based on the transactions between market participants, which is a much different concept from current practice.

Financial institutions should review and revise current policies that contain information about fair value to comply with the FAS 157 measurement guidelines. Institutions should also identify the types of instruments to which the fair value measurements will be applied and provide for a strong risk management process, including internal control, that is designed to ensure that the fair value measurements are managed, monitored, and reported in accordance with this standard. Revised policies should be approved by the board of directors. The September 30, 2007, supplemental Call Report instructions include additional information about FAS 157. We urge financial institutions to review these instructions, as well as FAS 157, with your CPAs to properly implement its required adoption as of January 1, 2008. If you have any questions in this regard, please contact Staff CPA Mrs. Dale Jacobs at 225/922-0632 or by email at djacobs@ofi.louisiana.gov.

Adoption of FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities* – FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159), issued in February 2007, allows financial instituions the option of reportiing certain financial assets and liabilities at fair value with the changes in fair value included in earnings. This statement may be obtained from the following web address: www.fasb.org/pdf/fas159.pdf.

FAS 159 is effective as of the beginning of a financial institution's first fiscal year that begins after November 15, 2007, and should not be applied retrospectively to prior fiscal years, except as permitted in the standard's early adoption provisions. If an institution has not applied the FAS 159 early adoption provisions, on January 1, 2008, FAS 159 becomes effective. At that time, an institution may decide to (1) substantively adopt the fair value option on a go-forward basis for eligible items that exist on January 1, 2008, or (2) adopt the standard without availing itself of the fair value option for existing eligible items on January 1, 2008.

If a financial institution adopts under #1 above, the financial institution must report the effect of the first re-measurement of the existing items to fair value as a cumulative-effect adjustment to the opening balance of retained earnings at the beginning of the fiscal year of adoption. The difference between the carrying amount and the fair value of eligible items for which the fair value option is elected at the effective date should be removed from the balance sheet (Schedule RC) and included in the cumulative-effect adjustment. This adjustment should be reported in Schedule RI-A, item 2, "Restatements due to corrections of material accounting errors and changes in accounting principles," and separately disclosed in Schedule RI-E, item 4.a. Fair value assets should be reflected as trading assets on Schedule RC and also reported in Schedule RC-Q.

An institution that adopts under #2 above will not need to make any cumulative effect adjustments to the beginning balance of retained earnings, since no existing assets or liabilities will be re-measured under FAS 159 at the date of adoption. If at a later date, an institution decides to choose the fair value option for an existing asset or liability, the difference between the reported value and fair value will flow through earnings. Under both methods, if an institution later chooses the fair value option for newly purchased assets, it will record the purchase at fair value and report any changes in fair value through the earnings statement. The September 30, 2007, supplemental Call Report instructions include additional information about FAS 159. We urge financial institutions to review these instructions, as well as FAS 159, with your CPAs to properly implement its required adoption as of January 1, 2008.

Additional guidance for institutions that adopt FAS 159 and elect the fair value option - If a financial institution adopts FAS 159 and elects the fair value option, it should have written policies pertaining to the use of the fair value option, which identify the types of instruments to which the option will be applied and provide for a strong risk management process, including internal control, that is designed to ensure that the use of the fair value option is managed, monitored, and reported in a sound manner. The policies should be approved by the board of directors. Management should provide, for the board's review, an explanation of the reasons for electing the fair value option for the types of instruments to which the option will be applied along with an assessment of the impact of the use of the option on the financial institution's financial condition and performance.

In order to be consistent with the FAS 159 disclosure requirements, if the fair value option is elected for some, but not all of the financial instruments within a group of similar financial instruments, management should provide the reason for a partial election of the option. Since securities reported as trading securities are carried at fair value with changes in fair value reported in current earnings, earnings volatility will be greater than if the securities were reported as available-for-sale or held-to-maturity. Thus, the financial institution's written policies on its use of the fair value option should address the actions it will take to mitigate the earnings volatility produced by the trading securities when the volatility exceeds or is expected to exceed board-approved risk limits. This also reinforces the need for the financial institution's risk management process to measure and monitor the impact of the application of the fair value option to securities (and any other financial instruments to which the option may be applied).

There should be regular reporting to senior management and the board of directors on the extent of the use of the fair value option and its impact on the financial institution's financial condition and performance. Any financial statements prepared in accordance with GAAP that the financial institution issues must fully comply with the FAS 159 (and FAS 157) disclosure requirements. The financial institution should follow any additional supervisory guidance on the use of the fair value option that the federal financial institution regulatory agencies or this office issues.

Additionally, depending on the dollar amount of securities that a financial institution will be reporting as trading securities, the amount of assets reported as trading in its Call Report could cause the financial institution to exceed one of the thresholds for the market risk rule within the risk-based capital standards (Appendix C to Part 325). Management must be aware of and implement controls for exceeding these limits. Please contact Staff CPA Mrs. Dale Jacobs with any questions 225/922-0632 or by email at djacobs@ofi.louisiana.gov.

Investment in Bank-Owned Life Insurance (BOLI) – At the LBA's recent Executive Management Conference, OFI's Staff CPA Mrs. Dale Jacobs and Metairie Bank & Trust Company's SVP Bill Haacke, gave a joint presentation entitled "*BOLI From A Regulator's Perspective*." The presentation included an overview of the 2004 BOLI Interagency Policy Statement requirements, a "hands-on" discussion of the pre-purchase analysis performed by Bill Haacke in his institution's BOLI decision-making process, and the new accounting standards that institutions must follow for split dollar benefits that extend into post retirement. The new accounting requirements are summarized below.

Accounting for Split-Dollar Life Insurance Arrangements - Financial institutions often use split-dollar life insurance arrangements to provide retirement and death benefits to employees. These arrangements are commonly structured as either "endorsement" split-dollar arrangements or "collateral assignment" split-dollar arrangements. Within the past year, the Financial Accounting Standards Board (FASB) has ratified separate consensuses reached by its Emerging Issues Task Force (EITF) on the accounting for these two types of arrangements. The consensuses contained in **EITF Issues No. 06-4 and No. 06-10** cover endorsement and collateral assignment and split-dollar life insurance arrangements, respectively. These pronouncements may be obtained from the following FASB website addresses: www.fasb.org/pdf/abs06-4.pdf and www.fasb.org/pdf/abs06-10.pdf, respectively. As a consequence, institutions that have entered into split-dollar arrangements with employees now need to review how they account for them. For many financial institutions, the application of the EITF consensuses will result in a change in accounting principle that will require institutions to recognize a liability at the beginning of 2008 for any benefits provided to these employees that extend to postretirement periods. We suggest that you meet with your CPAs and benefit consultants to obtain the information needed to properly calculate these liabilities.

The FDIC issued additional guidance in its *Summer 2007 Supervisory Insights* Issue, which can be found at the following address:

http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum07/Summer%2007_SupInsights.pdf

Under these EITF statements, if an institution has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit, the employer should recognize a liability for its postretirement benefit obligation to the employee. The liability must be recognized in accordance with FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions (FAS 106)*, "if, in substance, a postretirement benefit plan exists," or Accounting Principles Board Opinion No. 12, *Omnibus Opinion*-1967 (APB 12), "if the arrangement is, in substance, an individual deferred compensation contract."

A financial institution whose current split-dollar life insurance accounting practices differ from the consensuses reached by the EITF will generally report the cumulative effect of applying the consensus as of January 1, 2008, as a direct adjustment to its equity capital in item 2 of Call Report Schedule RI-A-Changes in Equity Capital, and disclose this amount in item 4 of Schedule RI-E-Explanations. Since the application of the consensuses in EITF 06-4 and EITF 06-10 may require financial institutions with split-dollar life insurance arrangements to initially recognize a liability for postretirement benefits, which will reduce both equity capital and regulatory capital, and to subsequently recognize compensation costs over the remainder of the employees' required service periods until their full eligibility dates, financial institutions should use the transition period during 2007 for risk management reviews to assess the substance of their split-dollar arrangements.

Examiners have been instructed to ensure that management is aware of the recent accounting guidance issued by the EITF and is assessing, or has completed an assessment of, the impact that the consensuses will have on their organization as part of a timely risk management review of these insurance arrangements. In cases where management has not yet taken appropriate action, examiners will seek management's commitment to promptly address the EITF guidance relevant to its split-dollar arrangements. If you have any questions in this regard, please contact Staff CPA Mrs. Dale Jacobs at 225/922-0632 or by email at djacobs@ofi.louisiana.gov.

Recent Examination Topics of Interest – A number financial institutions refrained from charging or accruing late fees for consumer loans after Hurricanes Katrina and Rita. During some recent examinations, examiners noted that the institutions have neglected to reset the computer programming code resulting in the continue omission of late fee accrual. Unless it is managements desire to continue not charging late fees on it consumer loan portfolio, it is recommended that management confer with its Information Technology department or services to determine if the code has been properly reset. Please contact Deputy Chief Examiner Kerry Morris with any questions.

Closing Comments – Please accept my sincere appreciation of your continued support of this Office, and know that we are always looking for ways to improve the manner in which we assist you. If you have noticed an area in which we are not excelling, regardless of whether it has always been that way, please let me know. You can call me directly at 225-925-4675, or email sseymour@ofi.louisiana.gov. We can't do better if we don't know better!